

## Internal Revenue Service

## Department of the Treasury

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CC:CORP:3 PLR-118067-02  
Date:  
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Distributing =

Controlled =

Shareholder 1 =

Shareholder 2 =

Shareholder 3 =

Shareholder 4 =

Shareholder 5 =

Shareholder 6 =

Business A =

Business B =

a =

b =

c =

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State X =

Dear :

This letter responds to your request dated March 18, 2002, for rulings on the federal income tax consequences of a proposed transaction. You submitted additional information in letters dated May 3, 2002, and July 18, 2002. The information submitted for consideration is summarized below.

Distributing, a State X corporation, uses the accrual method of accounting and has a calendar tax year. Distributing is engaged in Business A and Business B. Distributing has only one class of voting common stock, which is held in the following proportions:

Shareholder 1	=	<u>a</u> %
Shareholder 2	=	<u>b</u> %
Shareholder 3	=	<u>b</u> %
Shareholder 4	=	<u>b</u> %
Shareholder 5	=	<u>b</u> %
Shareholder 6	=	<u>c</u> %

Shareholder 6 is an executor under the will of an estate.

We have received financial information which indicates that Business A and Business B have each had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

Distributing desires to insulate Business B and its assets from the regulations, liabilities, and risks associated with the operation of Business A. We have received information demonstrating that additional insurance would result in significant additional costs. Moreover, the corporate business purpose cannot be achieved through a nontaxable transaction that does not involve the distribution of stock of a controlled corporation and which is neither impracticable nor unduly expensive. Accordingly, in order to insulate the assets of Business B from the risks of Business A, the following transaction has been proposed:

- (i) Distributing will form a new corporation (Controlled) as a State X corporation. Controlled will use the accrual method of accounting and have a calendar tax year.

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- (ii) Distributing will transfer all of the Business B assets to Controlled in exchange for all of the issued and outstanding stock of Controlled and the assumption by Controlled of the liabilities associated with Business B.
- (iii) Distributing will distribute all of the Controlled common stock pro rata to its shareholders.

The following representations have been made in connection with the proposed transaction:

- (a) No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (b) The five years of financial information submitted on behalf of Distributing is representative of the corporation's present operations, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (c) Following the transaction, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees, except that certain employees will be shared for reasons of efficiency and cost effectiveness. If any employee is shared by the two corporations such employee's compensation will be shared by the two corporations based upon the amount of time spent in each business.
- (d) The distribution of the stock of Controlled is carried out for the following corporate business purpose: In order to insulate the assets of Business B from the risks of Business A without incurring significant additional insurance costs. The distribution of the stock of Controlled is motivated, in whole or substantial part, by this corporate business purpose.
- (e) Distributing is an S corporation (within the meaning of § 1361(a)). Controlled will elect to be an S corporation pursuant to § 1362(a) on the first available date after the distribution and there is no plan or intent to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.
- (f) There is no plan or intention by the shareholders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in either Distributing or Controlled after the transaction except for the distribution by Shareholder 6 to its beneficiaries, which will distribute the stock of Distributing and Controlled in the same proportions.

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- (g) There is no plan or intention by either Distributing or Controlled, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the transaction, other than through stock purchases meeting the requirements of § 4.05(1)(b) of Rev. Proc. 96-30.
- (h) There is no plan or intention to liquidate either Distributing or Controlled, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the transaction, except in the ordinary course of business.
- (i) The total adjusted bases and the fair market value of the assets to be transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities to be assumed (as determined under § 357(d)) by Controlled.
- (j) The liabilities to be assumed (as determined under § 357(d)) in the transaction were incurred in the ordinary course of business and are associated with the assets being transferred.
- (k) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of the Controlled stock.
- (l) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (m) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (n) The distribution of Controlled stock is not part of a plan or series of related transactions (within the meaning of § 355(e)) pursuant to which one or more persons will acquire, directly or indirectly, stock possessing 50 percent or more of the total combined voting power of all classes of stock of either Distributing or Controlled entitled to vote, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled.
- (o) Immediately after the distribution, no person will hold "disqualified stock" in Distributing or Controlled, which constitutes a 50 percent or greater interest in such corporations within the meaning of § 355(d).

Based solely on the information submitted and representations made, we hold as follows:

- (1) The transfer by Distributing of the Business B assets to Controlled in exchange for all of the issued and outstanding stock of Controlled and the assumption by

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Controlled of the liabilities associated with Business B, followed by the distribution, as described above, will qualify as a reorganization under § 368(a)(1)(D). Distributing and Controlled each will be a “party to a reorganization” under § 368(b).

- (2) Distributing will recognize no gain or loss upon the transfer of the Business B assets to Controlled in exchange for Controlled stock and the assumption of liabilities, as described above (§§ 361(a) and 357(a)).
- (3) Controlled will recognize no gain or loss on the receipt of the Business B assets in exchange for Controlled stock, as described above (§ 1032(a)).
- (4) Controlled's basis in each asset received from Distributing will equal the basis of such asset in the hands of Distributing immediately prior to the transfer (§ 362(b)).
- (5) Controlled's holding period for each asset received from Distributing will include the period during which Distributing held such asset (§ 1223(2)).
- (6) Distributing will recognize no gain or loss on the distribution of the Controlled stock (§ 361(c)(1)).
- (7) Distributing's shareholders will recognize no gain or loss (and no amount will be included in the income of Distributing's shareholders) upon their receipt of the Controlled stock, as described above (§ 355(a)(1)).
- (8) The aggregate basis of the Distributing and Controlled stock in the hands of each Distributing shareholder immediately after the distribution will equal the shareholder's aggregate basis in his or her Distributing stock immediately before the distribution, allocated in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) (§§ 358(a)(1), (b) and (c)).
- (9) The Distributing shareholders' holding period of the Controlled stock received in the distribution will include the holding period of the Distributing stock on which the distribution is made, provided that such Distributing stock is held by the Distributing shareholder as a capital asset on the date of the distribution (§ 1223(1)).
- (10) Earnings and profits will be allocated between Distributing and Controlled in accordance with § 1.312-10(a).

We express no opinion about the tax treatment of the proposed transaction under other provisions of the Internal Revenue Code and regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the

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proposed transaction that are not specifically covered by the above rulings. Specifically, no opinion is expressed concerning the tax consequences of the corporation's S corporation status.

This ruling is directed only to the taxpayers requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

It is important that a copy of this letter be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this ruling letter is consummated.

Sincerely yours,

*Richard E. Coss*

Richard E. Coss  
Assistant to the Branch Chief, Branch 3  
Office of Associate Chief Counsel  
(Corporate)

cc: